Analysis

The tax transparency agenda

SPEED READ The tax transparency agenda is now relevant to all sectors, and brings with it compliance burdens, risks and opportunities beyond just reporting taxes paid. Businesses need to consider how they address this challenge by developing a proactive approach to transparency and wider tax governance. Combined with the right stakeholder engagement, this will help businesses to tackle the current climate of mistrust.

Tim Law runs Engaged Consulting Ltd, a boutique tax practice specialising in tax policy, strategy, governance, transparency and stakeholder engagement. His background includes over 15 years in blue-chip corporate tax teams and he has been at the heart of the extractives tax transparency policy debate. Email: tim.law@engaged-consulting.com; tel: 07960 658828.

It seems impossible to open a newspaper without seeing the latest celebrity tax scandal or another multinational company being challenged over its tax affairs. There will always be some who flout the law, but it has become a normal topic of conversation to discuss the acceptable mitigation of tax liabilities, what constitutes aggressive tax avoidance, and whether morality or patriotism have a part to play.

NGOs, the media and government committees have launched direct challenges at individuals and businesses. One aim was to shame those perceived to have strayed beyond mere tax mitigation into an area void of morality. The other two key consequences have been:

- mandatory tax transparency – aimed at flushing out the nefarious activities of taxpayers or the host governments to whom they pay taxes; and
- changes to domestic and international tax rules – aimed at preventing these perceived abuses (including EC state aid challenges).

This article focuses on the first of these issues, the introduction of mandatory tax transparency rules, and what businesses, whether or not subject to these rules, should be doing to address these challenges.

Until now these rules have been aimed at the extractive industries and the banks. Now they are looming large for all sectors. The days when communicating the tax affairs of a business meant a few choice numbers and a statement about complying with the law are now long gone.

As the author and policy academic Ivan Krastev said: 'Transparency is not about restoring trust in institutions. Transparency is the politics of managing mistrust.'

To contextualise the current tax transparency debate, I will first examine where it has come from, then where it might be going, and finally address what businesses should be doing right now.

Ancient history

The tax transparency debate is far from new, particularly for the extractive sector. Mining, oil and gas companies have been under scrutiny over their tax payments for a long time. This stems from three key factors:

- the non-renewable nature of minerals and fossil fuels: taxes generated by natural resources will only arise once;
- natural resources can only be extracted where they are discovered, require billions of dollars of investment and generate returns over decades. Many of the poorest countries in the world are endowed with some of the most plentiful natural resources – the so called 'resource curse'; and
- extractive companies invest huge sums and earn volatile returns, with perceived super profits when prices are at their peak (although it should of course be noted that the value of your natural resources can go down as well as up).

The story really starts in 1999 with the Global Witness report *A crude awakening*, which coined the phrase 'publish what you pay'. This was picked up by the NGO community and governments, and led directly to two key events in 2002:

- The NGO Publish What You Pay 'PWYP' was formed as a specific campaign, calling for extractive companies to publish what they paid to governments. Originally a coalition of six existing NGOs, it now represents over 800 member organisations worldwide and is at the forefront of the transparency debate.
- The Extractive Industries Transparency Initiative (EITI) was formed, as outlined in a speech Tony Blair released (although never delivered) at the World Summit on Sustainable Development in Johannesburg.

A little later PWYP, with the support of George Soros, called for the IASB to introduce a new country by country accounting standard, requiring companies to prepare a set of consolidated financial statements for each country of operation. Despite two attempts to convince the IASB, no new accounting standard was forthcoming. However, the campaign for country by country reporting, as championed by Richard Murphy, has continued.

The question remains as to what turned a rather niche debate about the revenues generated by mining, oil and gas companies, and the 'resource curse', into what looks like becoming a compliance burden for a wide range of businesses.

It would be easy to point to the high profile cases in the UK press (Amazon et al.) or the crisis in the banking sector, and the opacity over the risks

The Extractive Industries Transparency Initiative

When a country chooses to implement EITI it requires:

- all extractive companies in an implementing country to disclose the taxes they pay to the government of that country;
- the government to disclose its tax receipts; and
- a reconciliation to be performed. Differences often arise, but are frequently due to the timing of payments.

To date, 29 countries are EITI compliant, and another 17 countries are in the process of becoming compliant. Most of these are resource rich developing countries, but there has been a recent wave of countries such as the UK applying for EITI status.

inherent in those institutions. Or one could point at the campaigns run by NGOs, such as ActionAid.

In reality, there was no single catalyst. A combination of some household names, a global financial crisis leaving governments keen to maintain tax revenues, austerity, a growing anti-globalisation movement and improvements in the ability of activists around the world to communicate and collaborate through social media have all been cited as contributory factors.

Whatever the truth, responses by policy makers are coming from all angles. Multiple initiatives are popping up at EU, OECD and national levels, sharing one common theme. There is a belief that the current regime is broken and needs fixing.

In PwC's most recent global CEO survey, three-quarters agreed that it was important that their company was seen to be paying its 'fair share' of tax. (What those CEOs meant by 'fair share' is perhaps something for the heads of tax of those companies to raise!)

The present day

The tax transparency agenda is travelling down five avenues. The first two are driven by significant political will at national, G7 and G20 levels.

Mandatory public disclosure regimes: So far these have been mostly aimed at the extractive sector, but the spotlight is moving and it would be naïve to think that other sector are immune.

The US Dodd-Frank Act was passed in 2010, and included tax transparency rules. Following a lawsuit from US oil and gas companies, the Dodd-Frank rules were vacated, but new proposals are expected in the next six months or so.

The European Commission declared an intention to develop a EU transparency requirement, going at least as far as the US. The new EU Accounting and Transparency Directives were passed by the European Parliament in July 2013, including project by project tax transparency rules. UK extractive companies will be reporting on 2015 tax payment during 2016.

In essence, both of these regimes require companies to publicly disclose all the payments made to governments worldwide, on a project by project basis, so that communities can hold those governments to account for those revenues. The stated focus is on where the money goes.

Norway has introduced a similar law, and Canada is also looking to do the same, again initially for the extractive sector. In this case, NGOs including PWYP Canada are calling for rules that at least match those in the European Union.

In addition, there are the much-discussed CRD IV disclosure requirements facing financial institutions.

Enhanced submissions to government: The most significant move in this area is the OECD BEPS project. Much has been written about the pros and cons of the BEPS country by country (CbC) disclosures proposed under action 13 of BEPS. Many readers will have made representations, and I will not presume to elaborate on those here. However, in the context of the wider transparency debate, the proposals:

- have a very different stated objective. Rather than challenging governments about the monies they receive, they are intended to be a 'high level transfer pricing risk assessment tool';
- require disclosures to be made to host governments rather than publicly; and
- extend beyond just the tax payments, to include information about the revenues and profits in each country.

In addition, there is of course FATCA and other requirements not related to transfer pricing.

Tax on the AGM agenda: The emergence of tax onto the boardroom agenda nearly ten years ago was a significant step, and heralded tax emerging from the confines of the tax department. Tax is now on the AGM agendas of most multinational enterprises (MNEs). This year in particular has seen the rise of a number of new activist groups

Voluntary transparency

The question is why some businesses have chosen to voluntarily make tax disclosures.

From the oil and gas sector, Statoil and Tullow Oil have been proactive in early adopting transparency requirements, while mining giants Anglo American and Rio Tinto have been vying to produce the most useful and meaningful tax transparency for stakeholders for some time.

In other sectors, companies have chosen to make voluntary tax disclosures when they either have multiple material disputes with tax authorities, or are subject to an industry specific tax regime they want to highlight to stakeholders, such as the drinks industry. Notably, in July retailer Lidl voluntarily disclosed the amount of UK tax generated in 2013 by its 600 UK stores. Some commentators have attributed this to Lidl having concerns that adverse tax publicity could impact footfall.

In 2012 Colombia University, New York published a study called *The business case for transparency* that claimed a direct correlation between country by country tax transparency and financial performance.

More broadly, some clear drivers of transparency ultimately come back to shareholder value in one form or another:

- best practice: the accepted benchmark for sustainable development reports, the global reporting initiative (GRI), includes a requirement to disclose tax payments on a country by country basis. Businesses producing these reports will already appreciate the reputational consequences of not meeting best practice;
- differentiation: in a world where businesses are vying to be the 'leader' or 'preferred' operator in their sector, tax transparency can be an element of that differentiation; and
- stakeholder management: there is nothing new in the idea that you want to try to build relationships with your stakeholders before you need to rely on those relationships.

PwC's building public trust awards

Winners of one or more tax reporting awards from 2006 to 2013:

- Anglo American
- AstraZeneca
- Kazakhmys
- Legal & General
- Pennon Group
- Provident Financial
- The Rank Group
- Rio Tinto
- Vodafone Group

attending AGMs, with the aim of raising the issue of tax, and we have seen challenging questions posed to boards on their approach to tax, answered with varying degrees of success.

It's not just about the tax contribution: When PwC first introduced the concept of total tax contribution (TTC), it was quite a revolutionary step, with its idea of an agreed methodology and a report across a number of businesses.

The TTC methodology has had its critics, but it was a fundamental step in understanding the amount of tax generated by businesses. However, the debate has moved on. Although TTC remains important, many are now recognising that the taxes a business pays are only part of the story, and that it is the total economic contribution of those businesses which is important and about which it is helpful to be transparent.

It's not even just about the numbers: Tax transparency is not just about taxes paid. It's also about tax governance and, more importantly, how businesses demonstrate the existence of that governance to their stakeholders.

Stakeholders now expect businesses to have a tax strategy, preferably approved at the highest level in the organisation, and acknowledged or even published externally. They also expect tax policies to support that strategy and governance structures to ensure adherence to those policies.

In a world where tax has traditionally been about numbers and legislation, this sort of challenge often sits less comfortably with tax professionals. But it is just as important, if not more so.

The future

As the physicist Niels Bohr said: 'Prediction is very difficult, especially if it's about the future.'

What we know is that UK extractive companies will be reporting taxes on a project by project basis from 2015, with data in the public domain in 2016. At the same time as other countries may have introduced their own new rules for extractives, Dodd-Frank may be back on the table and BEPS CbC will be on the way for everyone. The review clause in the EU Accounting Directive then requires a report which 'shall consider the extension of the reporting requirements to additional industry sectors'.

At the same time, the EU Non-Financial Reporting Directive requires a report on whether to introduce a country by country reporting requirement of profits, taxes paid and subsidies for all companies.

One thing is certain. The transparency debate is not going away. When the first project by project data becomes public, there will be a surge of NGO and media activity as the data is examined. This will undoubtedly include businesses facing lots of questions about the published numbers and what they mean. Indeed, whether or not a business is currently subject to one of these reporting regimes, the questions will probably still come.

Of course, these disclosures won't prove the universal panacea and will not result in a row of large neon arrows pointing at smoking guns. It remains unclear how activists and policy makers will respond if the outcome of the current wave of reform does not look like the success they are hoping for. Further reform and more transparency is an obvious possibility.

Public trust is an increasingly important issue for businesses in all sectors. Tax transparency is an essential part of building that trust. For some years, PwC has included awards for tax reporting as part of its building public trust awards.

Next steps for business

Businesses need to keep responding to the changing tax agenda. Whatever business sector it might be, the time to act is now.

Many businesses are recognising the advantages of taking a proactive approach, seeking to influence policy makers and proactively engaging with stakeholders. Tax directors have long understood that there is a benefit in building a constructive relationship with tax authorities. This is now just as true for the wider stakeholder population.

What businesses can do right now is to implement the following three point plan:

- Understand the tax environment as it applies to your business. That means identifying your tax stakeholders, what drives them and their spheres of influence. Also, understand the transparency agenda as it applies to your business and where that agenda is heading.
- Get your house in order. Address the governance issues by having a tax strategy, tax policies and a supporting governance structure. Start looking at what data you might need to report and how to collect and validate that data.
- Think wider. Stakeholders aren't really interested in the numbers per se. What's more interesting is what the numbers mean and the story they tell. Businesses need to have a strong tax narrative and messaging to support that.

This is where businesses can make a real difference. Whatever information ends up in the public domain, a story will be built around it. The opportunity is there for businesses to take this on, and tell the story of their activities in a way only the business can. If not, it will be left for others to make the stories and businesses to spend their time refuting them.

Ultimately, the direction in which the transparency agenda goes from here is more about political will than corporate behaviour. Challenges are coming from governments, NGOs and other stakeholders. However, the only people who can change the perception that businesses are generally immoral tax avoiders, are businesses and those who represent them.

Going back to Ivan Krastev, it is now incumbent on tax professionals to manage the climate of mistrust. ■

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